New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB- A-88 (8)C
Corporation Tax
March 18, 1988

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. C870910A

On September 10, 1987, a Petition for Advisory Opinion was received from Brooklyn Union Gas Company, 195 Montague Street, Brooklyn, New York 11201.

The issue is whether, for purposes of sections 186 and 186-a of the Tax Law, profits from the sale of securities (stocks, bonds, and options) are subject to allocation using the issuer's allocation percentage of the security sold.

Petitioner, a public utility, invests in the stock of unrelated corporations. These stocks yield dividends that are taxable under section 186 and 186-a. Under both section 186 and section 186-a, the portion of such dividends that is allocated to New York State sources is computed using the payer's issuer's allocation percentage. When Petitioner sells a stock and realizes a gain, Petitioner proposes to allocate such gain by using the same issuer's allocation percentage that is used for allocating the dividends received on such stock.

For example, in 1986 Petitioner invested $10,000 in the stock of Corporation X. Corporation X has a New York State issuer's allocation percentage of 25 percent. In 1987, Petitioner received $400 in dividends from Corporation X. Also in 1987, Petitioner sold its holdings in Corporation X for $11,000. Petitioner believes that it should be allowed to allocate the $1,000 gain on the sale of the securities in the same manner as the $400 in dividends so that the total amount subject to New York State tax would be $350 (25% of $1,000 + $400).

Petitioner states that while sections 186 and 186-a are silent as to the method used to allocate the gains from the sales of securities, the business corporation franchise tax, under Article 9-A, is specific in that investment income, which includes capital gains, can be allocated using the investment allocation percentage. Therefore, Petitioner contends that since the treatment of interest and dividends under sections 186 and 186-a parallels that allowed under Article 9-A, the treatment of gains on the sales of securities under sections 186 and 186-a should parallel the treatment of such gains under Article 9-A.

When section 186 was enacted, it provided for a franchise tax on various types of utility companies measured by their "gross earnings from all sources within this stately. In 1907, the Legislature amended section 186 by providing a statutory definition of gross earnings. Gross earnings is defined as "all receipts from the employment of capital without any deduction."

The definition of gross earnings was added to overcome the effect of a 1906 New York State Appellate Division Decision that held that in order to arrive at taxable "gross earnings", the cost of raw materials used in producing the utility service had to be deducted from the company's gross receipts.

(See People ex rel. Brooklyn Union Gas Co. v. Morgan, 114 App. Div. 266, affd 195 N.Y. 616). "The basis of the decision... was that, where the tax was limited by the statute to 'gross earnings', that limitation was too precise to permit the taxation of any receipts, which could not be classified as earnings, or profits, upon the capital invested." (People ex. rel. Westchester Lighting Co. v. Gaus, 199 N.Y. 147)

In 1969 the New York State Court of Appeals stated that "the 1907 amendment [of section 186] did not contemplate a substitution of 'capital' or 'gross receipts' for 'gross earnings' as the basis for taxation. It merely sought to include that portion of capital which the Brooklyn Union Gas Co. case [supra] required to be deducted from 'gross earnings' to arrive at the proper basis. This is only that portion of 'gross earnings' which represents the 'employment of capital' to manufacture, distribute and sell various public utility services." (Matter of Consolidated Edison Co. of N.Y. v. State Tax Commission, 24 NY2d 118). In the Consolidated Edison Co. case, the court determined that (assuming there was no gain on the transactions) the proceeds received by the company for property damage and insurance claims and from the sale of capital assets no longer employed in its business, consisting of real property, scrap and used machinery, are amounts realized from the destruction or confiscation of capital, not from the employment of capital.

Based on legislation and the decisions of the courts, it is determined that the ins on the sales of securities (stocks, bonds and options), rather than the entire proceeds, are receipts from the employment of capital and as such, constitute gross earnings under section 186. The statute states that no deductions from gross earnings are allowed. Therefore, expenses that are attributable to the sales of securities are not deductible. In addition, when the sale of a security results in a loss, such loss may not be deducted f rom a gain derived from another transaction.

Petitioner errs in its contention that under section 186 of Article 9 gains on the sales of securities should be treated similar to the Article 9-A treatment of such gains. The statutes are dissimilar. Article 9-A is a franchise tax based on the taxpayer's entire net income or portion thereof allocated within New York State. Entire net income consists of investment income and business income. As previously stated, section 186 of Article 9 imposes a franchise tax based on gross earnings from all sources within New York State. Section 186 is akin to section 184 of Article 9 which imposes a franchise tax on transportation and transmission corporations based on gross earnings from sources within New York State.

In American Tel. & Tel. Co. v State Tax Commission, 93 AD2d 66; affd. 61 N.Y. 2d 393, it was held that, for purposes of section 183 of Article 9, where securities in a temporary cash investment account belonged to the parent telephone company and involved multitudinous purchases and sales, all of which incurred in New York, and required constant monitoring by the parent company's treasury department personnel in New York State and the parent telephone company earned substantial income from it, such account constituted taxable assets of the parent company

employed in New York State. The court also determined that for purposes of section 184 of Article 9, the State Tax Commission incorrectly attempted to impose a tax based not on the source of income but on where assets giving rise to the income were employed. Therefore, the court held that interest income received by the parent telephone company from obligations of out-of-state obligors on such Temporary investments were not earned from a "source" within New York State. However, such decision did not determine the source of the gains realized on the sale of such securities.

It is apparent from the American Tel. & Tel. Co. case, (supra) , that the crucial factor in determining the amount of gross earnings from all sources within New York State is the meaning of "source". The court stated "[c]ommon words are to be given their commonly understood meaning (Matter of Steinbeck v. Gerosa, 4 NY2d 30:2, app. dsmd. 358 U.S. 39).

For purposes of section 186, the gains on the sales of securities are sourced in New York State when the taxpayer exercises extensive management, control and utilization of such intangibles in New York State and when such activity is an integral and substantial part of the taxpayer's business conducted in New York State. (see People ex rel. Manila Electric R.R. & Lighting Knapp, 229 N.Y. 502; People ex rel. Tobacco & Allied Stocks, Inc. v. Graves, 250 App. Div. 149, affd. 277 N.Y. 723; People ex rel. Manhattan Silk Co. v. Kelsey, 125 App. Div. 296; People ex rel. North American Co. v. Miller, 90 App. Div. 560; People ex rel. Brooklyn Rapid Transit Co. v. Miller, 85 App. Div. N.Y. 582; People ex rel. New England Loan Co. v. Roberts, 25 App. Div. 16)

In the instant case, Petitioner's principal activity is that of a utility company and in furtherance of such business Petitioner conducts financial activities including the business of the buying and selling of securities (stocks, bonds .ind options). Such transactions are an integral part of Petitioner's total business activities.

Accordingly, pursuant to section 186 Petitioner must include in "gross earnings from all sources within this state", the gains on the sales of securities where such securities are managed, controlled and utilized in New York State. No deduction is allowed for expenses attributable to the sales of securities and where a sale results in a loss, such loss may not be deducted.

Section 186-a provides a tax on the furnishing of utility services that is equal to three percent of the gross income of a utility that is subject to the supervision of the New York State Department of Public Service. Gross income as defined in section 186-a2(c) consists of the following elements:

1. receipts from any sale made or service rendered for ultimate consumption or use by the purchaser in New York State;

2. profits from the sale of securities;

3. profits from the sale of real property;

4. profit from the sale of personal property (other than inventory);

5. receipts from interest, dividends, and royalties, derived from sources within blew York State; and

6. profits from any transaction (except sales for resale and rentals) within blew York State whatsoever.

Section 501.1.0 of the Tax on the Furnishing of Utility Services regulations states that:

(a) The law provides that there shall be included in gross income "profits from the sale of securities". Securities include generally stocks, bonds, rights to stock, etc.

(b) The essential nature of the transaction determines whether there is one or more sales involved. For example, a utility during the reporting period sells stock in two different corporations realizing a gain in one case and a loss in the other. The transaction is considered as two sales and the profit is required to be included in gross income without any deduction on account of the loss sustained. If, however, a utility carries a block of 10,000 shares of the same securities of a corporation in its portfolio and orders its broker to sell the entire block, the fact that the broker executes the order by disposing of the block in several lots does not change the essential nature of the transaction and make it more than one sale. In determining the profit from this transaction, the net amount is required to be included in gross income so that if, during the reporting period, some portion of the above mentioned securities are sold at a gain and some at a loss, only the net prof it is taxable. This transaction is considered as one sale for purposes of this tax.

Question 43: A utility sells 1,000 shares of the stock of A corporation during the month of November, 1950, and realizes a profit of $5,000. During the same month, it sells 500 shares of the stock of B corporation and sustains a loss of $1,500. What amount is includible in gross income? Answer: $5,000.

Question 44: A utility sells 100 United States Government bonds and 10 bonds of the State of New York realizing a profit on each sale. Must the profits on such sales be included in gross income? Answer: Yes, profits on the sale of tax exempt securities are taxable.

Question 45: Is profit realized by a utility on the sale of reacquired stock, or of securities of an affiliated company required to be included in its gross income? Answer: Yes.

It is clear that there is no provision in either section 186-a of the Tax Law or the regulations promulgated thereunder for allocating, within and without New York State, the profits from the sales of securities.

Accordingly, Petitioner must include in its gross income computed under section 186-a, all of the profits realized on the sales of securities, without allocation and without the deduction of any loss sustained on other sales of securities.

DATED: March 18, 1988

s/FRANK J. PUCCIA Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.